Petition

Office-Supreme Court, U.S.
FILED
JUL 27 1981
ALEXANDER L. STEVAS,
CLERK

No. 81-176

In the Supreme Court of the United States

OCTOBER TERM, 1980

BOARD OF GOVERNORS OF THE
FEDERAL RESERVE SYSTEM, PETITIONER

v.

SECURITY BANCORP AND SECURITY NATIONAL BANK

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

LAWRENCE G. WALLACE
Acting Solicitor General

STUART E. SCHIFFER
Acting Assistant Attorney General

STEPHEN M. SHAPIRO
Assistant to the Solicitor General

ANTHONY J. STEINMEYER
FREDDI LIPSTEIN
Attorneys

Department of Justice
Washington, D.C. 20530
(202) 633-2217

MICHAEL BRADFIELD
General Counsel

RICHARD M. ASHTON
Attorney

Board of Governors of the
Federal Reserve System
Washington, D.C. 20551

QUESTIONS PRESENTED

1. Whether a dispute with the Board of Governors of the Federal Reserve System concerning approval of an application to form a one bank holding company to control a particular bank is mooted when the bank in question is acquired by an unaffiliated entity and ceases to exist.

2. Whether the Board of Governors of the Federal Reserve System has authority to deny an application for bank holding company status under its statutory mandate to evaluate "managerial resources" when the management of the bank and the proposed holding company has engaged in improper business practices and has refused to cooperate with the Board by disclosing information needed to process the application.

TABLE OF CONTENTS

	Page
Opinions below	1
Jurisdiction	1
Statute involved	2
Statement	3
Reasons for granting the petition	8
Conclusion	19
Appendix A	1a
Appendix B	8a
Appendix C	10a
Appendix D	12a
Appendix E	13a
Appendix F	14a

TABLE OF AUTHORITIES

Cases:

Alabama v. *Davis*, 446 U.S. 903	12
Board of Governors v. *First Lincolnwood Corp.*, 439 U.S. 234	8, 9, 10, 14, 15, 17
Carroll v. *President & Commissioners of Princess Anne*, 393 U.S. 175	13
Great Western Sugar Co. v. *Nelson*, 442 U.S. 92	12, 13
A. L. Mechling Barge Lines, Inc. v. *United States*, 368 U.S. 324	13
SEC v. *Medical Committee for Human Rights*, 404 U.S. 403	13
United States v. *Munsingwear, Inc.*, 340 U.S. 36	7, 11, 12, 13

Statutes: Page

Bank Holding Company Act of 1956, ch. 240, 70 Stat. 133, 12 U.S.C. (& Supp. III) 1841 *et seq.*:
70 Stat. 135 14
Section 2(a), 12 U.S.C. (& Supp. III) 1841 (a) 3
Section 3, 12 U.S.C. (& Supp. III) 1842 ..... 2, 8
Section 3(a), 12 U.S.C. (& Supp. III) 1842 (a) 2, 3, 7
Section 3(c), 12 U.S.C. 1842(c) 2, 3, 14, 15

Bank Merger Act, Pub. L. No. 86-463, 74 Stat. 129 15
12 U.S.C. (& Supp. III) 1828(c) 15
12 U.S.C. (Supp. III) 1828(d) 16
12 U.S.C. 1828(i) 16

Change in Bank Control Act of 1978, 12 U.S.C. (& Supp. III) 1817:
12 U.S.C. (& Supp. III) 1817(j) 16
12 U.S.C. (& Supp. III) 1817(j)(1) 16
12 U.S.C. (Supp. III) 1817(j)(6)(A) 16
12 U.S.C. (Supp. III) 1817(j)(7)(D) 16
12 U.S.C. (Supp. III) 1817(j)(7)(E) 16
12 U.S.C. (Supp. III) 1817(j)(8) 16

Financial Institutions Supervisory Act of 1966, 12 U.S.C. (& Supp. III) 1464(e) 16
12 U.S.C. 1730a(e)(2) 16
12 U.S.C. (& Supp. III) 1818(e) 16
12 U.S.C. (& Supp. III) 1818(e)(2) 16

80 Stat. 237-238 15
12 U.S.C. 322 15
12 U.S.C. 1726(c) 16
12 U.S.C. 1754(2) 16
12 U.S.C. 1781(c)(1)(C) 16
12 U.S.C. (Supp. III) 1815(b) 15-16
12 U.S.C. 1816 15

Miscellaneous: Page

Board of Governors of the Federal Reserve System, *Application(s) for Prior Approval of Action to Become a Bank Holding Company*, F.R. Form Y-1, Exh. C (1979) 17
Comptroller General of the United States, *Federal Supervision of State and National Banks* (1977) 10
66 Fed. Res. Bull. 526 (1980) 6, 12
Federal Reserve System, *Form 83, Application for Membership in the Federal Reserve System* (1974) 15
Florida National Bank of Florida, Inc., 62 Fed. Res. Bull. 696 (1976) 16
G. Hill, *Why 67 Insured Banks Failed—1960 to 1974* (F.D.I.C. 1975) 10
H.R. Rep. No. 609, 84th Cong., 1st Sess. (1955) 14
H.R. Rep. No. 1221, 89th Cong., 2d Sess. (1966) 15
Kaufman, *Preventing Bank Failures*, reproduced in S. Comm. on Banking, Housing, and Urban Affairs, 94th Cong., 1st Sess., *Compendium of Major Issues in Bank Regulation* (Comm. Print 1975) 10
S. Rep. No. 1179, 89th Cong., 2d Sess. (1966) 15
Stokes, *Public Convenience and Advantage in Applications for New Banks and Branches*, 74 Banking L.J. 921 (1957) 16
Trust Co. of New Jersey-Wilshire Oil Co., 58 Fed. Res. Bull. 717 (1972) 17

In the Supreme Court of the United States

OCTOBER TERM, 1980

No.

BOARD OF GOVERNORS OF THE
FEDERAL RESERVE SYSTEM, PETITIONER

v.

SECURITY BANCORP AND SECURITY NATIONAL BANK

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

The Solicitor General, on behalf of the Board of Governors of the Federal Reserve System, petitions for a writ of certiorari to review the judgment of the United States Court of Appeals for the Ninth Circuit in this case.

OPINIONS BELOW

The opinion of the court of appeals (App. A, *infra*, 1a-7a) is not yet reported. The administrative decision of the Board of Governors of the Federal Reserve System (App. F, *supra*, 14a-19a) is reported at 64 Fed. Res. Bull. 405.

JURISDICTION

The judgment of the court of appeals (App. B, *infra*, 8a-9a) was entered on October 27, 1980. A petition for rehearing was denied on April 30, 1981 (App. D, *infra*, 12a). The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATUTE INVOLVED

Section 3 of the Bank Holding Company Act of 1956, 12 U.S.C. (& Supp. III) 1842, provides in pertinent part:

> (a) It shall be unlawful, except with the prior approval of the Board, (1) for any action to be taken that causes any company to become a bank holding company; * * *.
>
> * * * * *
>
> (c) The Board shall not approve—
>
> (1) any acquisition or merger or consolidation under this section which would result in a monopoly, or which would be in furtherance of any combination or conspiracy to monopolize or to attempt to monopolize the business of banking in any part of the United States, or
>
> (2) any other proposed acquisition or merger or consolidation under this section whose effect in any section of the country may be substantially to lessen competition, or to tend to create a monopoly, or which in any other manner would be in restraint of trade, unless it finds that the anticompetitive effects of the proposed transaction are clearly outweighed in the public interest by the probable effect of the transaction in meeting the convenience and needs of the community to be served.
>
> In every case, the Board shall take into consideration the financial and managerial resources and future prospects of the company or companies and the banks concerned, and the convience and needs of the community to be served.

STATEMENT

1. Under Section 3(a) of the Bank Holding Company Act of 1956, 12 U.S.C. (& Supp. III) 1842(a), it is "unlawful, except with the prior approval of the Board [of Governors of the Federal Reserve System], * * * for any action to be taken that causes any company to become a bank holding company * * *."[1] Congress has prescribed that, in considering whether to approve an application to form a bank holding company, the Board must, in "every case," evaluate "the financial and managerial resources and future prospects of the company * * * and the banks concerned." 12 U.S.C. (& Supp. III) 1842(c).

In April 1975, respondent Security Bancorp ("Bancorp") applied to the Board for permission to become a one bank holding company by acquiring respondent Security National Bank ("Security Bank") (App. A, *infra*, 2a). Mr. Adnan Khashoggi, a citizen of Saudi Arabia, owned virtually all of the shares of Bancorp and, at the time of the application, also owned 97% of the shares of Security Bank (*ibid.*). While the application was pending, several United States corporations disclosed that they had made payments to Saudi Arabian government officials to influence governmental action and that Mr. Khashoggi had acted as the intermediary in tendering those payments. On several occasions, the Board sought additional information concerning Mr.

---

[1] A "bank holding company" is defined in Section 2(a) of the Act, 12 U.S.C. (& Supp. III) 1841(a), as "any company which has control over any bank or over any company that is or becomes a bank holding company * * *." "Any company has control over a bank * * * if [*inter alia*] * * * the company * * * owns, controls, or has power to vote 25 per centum or more of any class of voting securities of the bank * * *" (*ibid.*).

Khashoggi's role in making the payments. The Board sought that information directly from Khashoggi and from the Department of Justice and the Securities and Exchange Commission, which also were investigating the alleged questionable payments (App. F, *infra*, 17a-18a). Khashoggi refused to cooperate with the government investigations and failed to disclose substantive information needed by the Board to evaluate his fitness to manage a federally regulated bank holding company. Thwarted in its effort to obtain the information, the Board denied Bancorp's application, explaining its action as follows (*ibid.*):

> During the pendency of the subject application, the Board was aware that investigations were being conducted by United States law enforcement authorities into questionable payment practices by United States companies and that those investigations also involved Mr. Khashoggi. In view of the investigations and Mr. Khashoggi's important position with respect to Bank and the proposed bank holding company, the Board requested from the United States Department of Justice and the Securities and Exchange Commission any information concerning Mr. Khashoggi that may be relevant to the banking factors the Board is required to consider under the Act. In connection with their investigations, the Department of Justice and the SEC have sought Mr. Khasoggi's testimony. Mr. Khashoggi, however, has been unwilling to submit to questioning in a manner satisfactory to those agencies. As a result of Mr. Khashoggi's lack of cooperation in these matters, the agencies have been unable to respond adequately to the Board's request for information.
>
> On February 17, 1978, the Board considered the subject application and was advised of ne-

gotiations then in progress between the Department of Justice and representatives of Mr. Khashoggi whereby it was anticipated that an agreement might have been reached in the near future for Mr. Khashoggi to submit to questioning. In view of the incomplete record and the prospect that those negotiations might soon result in an agreement, the Board decided not to take final action on the application at that time. Rather, the Board acted to defer a final decision on the application for 60 days and informed Applicant that when the Board reconsidered the application a relevant factor would be the status of the above investigations, and in particular, Mr. Khashoggi's cooperation in those investigations. * * *

Since it last considered the application, the Board has been informed that the negotiations with Mr. Khashoggi have been terminated and that he has not evidenced a willingness to cooperate with the agencies in their investigations. As a result, Mr. Khashoggi's lack of cooperation leaves unanswered the Board's original requests for information from the Department of Justice and the SEC. In addition, his lack of cooperation with formal investigations undertaken by United States law enforcement authorities raises some concern whether Mr. Khashoggi would be personally available and accountable to bank supervisory authorities should the need arise. In the Board's view, a requirement for a favorable finding with respect to an Applicant's managerial resources [is] that management will be accessible to and cooperate with supervisory personnel. Furthermore, Mr. Khashoggi's unwillingness thus far to cooperate with United States law enforcement authorities is not in keeping with

what the Board regards as acceptable conduct for the management of a bank holding company.[2]

2. Respondents petitioned the United States Court of Appeals for the Ninth Circuit for review of the Board's order. The court of appeals ordered the Board to "grant the application" (App. A, *infra*, 7a). The court concluded that the misconduct in question was collateral to "management's conduct of bank affairs" (App. A, *infra*, 5a), and thus was beyond the scope of a proper inquiry into "managerial resources." The court later denied the Board's petition for rehearing (App. D, *infra*, 12a).

3. On January 1, 1981, while the Board's petition for rehearing was pending in the court of appeals, respondent Security Bank was merged into The Hibernia Bank, San Francisco, California, an institution with which Khashoggi has no affiliation. As a result of that merger, Security Bank, the only institution proposed to be acquired by Bancorp in its application, ceased to exist. The Board promptly advised the court of appeals that, by virtue of the merger, Khashoggi had disposed of all of his shares in Security Bank, Security Bank had been merged into another entity that already was part of a holding company system approved by the Board (see 66 Fed. Res. Bull. 526 (1980)), and that the controversy concerning Bankcorp's application to acquire Security Bank therefore had become moot. The Board urged the court to vacate the panel's decision

---

[2] In view of Khashoggi's virtual sole ownership of Security Bank, his ability to select all of its directors and officers, and the pervasive directions he gave to the bank, the Board found that Khashoggi was part of the bank's management (App. F, *infra*, 16a-17a). The court of appeals did not disturb that finding.

to prevent that decision, now "unreviewable because of mootness, from spawning any legal consequences" (*United States* v. *Munsingwear, Inc.*, 340 U.S. 36, 41 (1950)).[5]

In a supplemental opinion (App. C, *infra*, 10a-11a), the court of appeals denied the Board's motion to vacate the panel's decision under *Munsingwear*. The court stated briefly that the case was not moot because the Board had not expressed "any desire to vacate the * * * decision denying a permit to Security Bancorp, and such action would be required if this Court were to vacate its opinion reversing the Board" (*id.* at 11a). The court also stated that respondents "have expressed concern about the effects of this controversy upon possible future dealings between the principals" (*ibid.*).

The Board then filed a motion to clarify and reconsider the court of appeals' supplemental opinion. The Board assured the court of appeals in that motion that "if the Court's decision is vacated, the Board will withdraw its order denying [Bancorp's] application to form a bank holding company, promptly upon regaining jurisdiction over this matter." Motion to Clarify and Reconsider Supplemental Opinion at 2. Vacation of the Board's order following remand would return all of the principals to precisely the

---

[5] See *The Board's Motion To Vacate the Court's Decision and Dismiss Petitions for Review As Moot.* The Board further explained to the court of appeals that its decision requiring the Board to approve the application could have no continuing significance to Khashoggi, Bancorp, or Hibernia. If any of those persons proposed to acquire a bank in the future, that proposal would require the filing of a separate application, which in turn would require separate evaluation on its own merits under 12 U.S.C. (& Supp. III) 1842(a). See *The Board's Reply to* [Bancorp's] *Opposition to Motion to Vacate The Panel's Decision As Moot.*

same position they occupied before the application had been filed. Nonetheless, the court of appeals denied the Board's motion without opinion and permitted its prior decision on the merits to stand (App. E, *infra*, 13a).

REASONS FOR GRANTING THE PETITION

1. This case involves an important question concerning the Board's authority to disapprove the formation of a bank holding company when there is evidence that the management of the bank holding company has engaged in improper business practices and has refused to provide material information to the Board that is essential in evaluating the application before it. Section 3 of the Bank Holding Company Act, 12 U.S.C. (& Supp. III) 1842, requires the Board, in "every case," carefully to evaluate the "managerial resources" of both the proposed holding company and the bank concerned. Congress gave the Board broad discretionary authority to deny applications based on deficient "managerial resources" to protect the financial integrity of the nation's banking system.

As this Court held in *Board of Governors* v. *First Lincolnwood Corp.*, 439 U.S. 234, 243 (1978), the statute authorizes the Board "to deny applications on grounds of financial or managerial unsoundness even in the absence of any anticompetitive impact." Moreover, the Board's power "encompasses cases in which the transaction would not weaken the bank or the bank holding company" (*id.* at 249-250); the Board properly may insist "that holding companies * * * be a source of strength to subsidiary financial institutions" (*id.* at 251). Finally, *First Lincolnwood* unequivocally rejected the assertion that the Bank Holding Company Act requires "the Board to ap-

prove formation of a bank holding company with corrupt management * * *." *Id.* at 250. The Court emphasized that "Congress has evinced substantial concern for the financial soundness of the banking system" (*id.* at 250), a concern that necessitates a broad interpretation of the Board's power to deny applications that are unsupported by a demonstration of sound "financial and managerial resources."

In accordance with these principles, the Board traditionally has considered any evidence bearing on the honesty, integrity or fitness of managerial personnel (see page 17, *infra*). The holding of the court of appeals in this case upsets the Board's important supervisory function by limiting its focus to conduct that is directly "[ ]connected to the assets of [the] banking institution * * * involved" (App. A, *infra*, 7a). Under this approach, the Board would be obliged to ignore evidence that management has engaged in corrupt behavior in other business contexts that reflects adversely on its ability to control a federally regulated banking institution. It also would be irrelevant, under the approach of the court of appeals, that management has displayed indifference to requests for information from the bank supervisory agencies, the Securities and Exchange Commission, and the Department of Justice. We submit that the court below clearly erred in accepting "a construction that would yield such an anomalous result" (*Board of Governors* v. *First Lincolnwood Corp.*, *supra*, 439 U.S. at 250).

Sound management is perhaps the single most important factor in safeguarding the nation's banking system. Conversely, incompetent or untrustworthy management is the chief cause of insolvency of fed-

erally insured banks.[4] The most effective method for averting harm to the banking system is to prevent untrustworthy managers from assuming control of banks and to encourage the replacement of untrustworthy management by persons who meet minimal standards of honesty and cooperativeness with bank regulatory agencies.

The decision of the court of appeals will greatly hamper the Board's exercise of its protective function in banking markets in West Coast states embraced within the Ninth Circuit. Due to the great practical importance of the court's ruling throughout a broad geographical area, and due to the inconsistency between the court's ruling and *First Lincolnwood*, this Court should correct the erroneous refusal of the court of appeals to vacate its decision on mootness grounds. If the Court believes that the case is not moot, it should grant the petition for certiorari and review the decision of the court of appeals on the merits.

2. *a.* Following the decision of the court of appeals in this case, The Hibernia Bank acquired Security Bank and Security Bank ceased to exist. Respondent Bancorp could not, therefore, pursue its plan to acquire Security Bank, which was the only

---

[4] According to a 1977 study by the General Accounting Office, the primary cause of 30 of the 42 bank failures that occurred between 1971 and 1976 was improper, unethical and dishonest practices of bank management. See Comptroller General of the United States, *Federal Supervision of State and National Banks* 9-3 (1977). See also Kaufman, *Preventing Bank Failures*, reproduced in S. Comm. on Banking, Housing, and Urban Affairs, 94th Cong., 1st Sess., *Compendium of Major Issues in Bank Regulation* 769, 773-776 (Comm. Print 1975); G. Hill, *Why 67 Insured Banks Failed—1960 to 1974* 1-3 (F.D.I.C. 1975).

proposal presented to the Board in the application in this case. In light of that fact, the Board urged the court of appeals to vacate its judgment and to remand the case to the Board so that the Board could vacate its administrative decision. If the rulings in this case had been vacated as urged by the Board, all of the parties would have been returned to the status quo ante without impairment of any legal right or interest.

Respondents have never identified any continuing legal interest in the ruling of the court of appeals that would justify an inference that the present case is not moot. Respondents' application related solely to an acquisition that no longer can take place. Any future bank acquisition by Khashoggi or Bancorp would require a separate application to the appropriate bank regulatory agency, which would be evaluated on its merits at a later time. Moreover, because the Board is prepared to vacate its administrative decision in this case, the Board's opinion and order can have no future effect on respondents.[5]

In these circumstances, the court of appeals, which retained jurisdiction of the case due to the pending rehearing petition, was obligated to vacate its decision on grounds of mootness. See *United States* v. *Munsingwear, Inc.*, 340 U.S. 36, 39 (1950). As the

---

[5] If, in a future case, respondents were to seek Board approval of a different application, and the Board were to deny the application on grounds similar to those relied on in the present case, respondents could seek appellate review of any adverse ruling of the Board. The Board, in turn, could seek review in this Court if its order were set aside. Thus, the important question here involved could be litigated in the context of a live case or controversy if it ever were to arise in the future.

Court emphasized in *Munsingwear*, this is the "duty of the appellate court." *Id.* at 40. Vacation of the court of appeals' decision would "clear[ ] the path for future relitigation of the issues between the parties and eliminate[ ] a judgment, review of which was prevented through happenstance." *Ibid.* It also would prevent a judgment, unreviewable in a higher court because of mootness, "from spawning any legal consequences." *Id.* at 41. See *Great Western Sugar Co.* v. *Nelson*, 442 U.S. 92, 93-94 (1979); *Alabama* v. *Davis*, 446 U.S. 903-904 (1980).

b. The court of appeals' reasons for refusing to vacate its opinion do not withstand analysis. The court stated that respondents' controversy with the Board may have an effect on "future dealings between the principals" (App. C, *infra*, 11a). However, the Board's willingness to vacate its administrative decision following remand from the court of appeals assures that the administrative decision can have no collateral consequences. Thus, any potential effects of the Board's administrative decision are entirely speculative.

As previously noted, moreover, Bancorp was formed by Khashoggi solely to acquire Security Bank, a bank that no longer exists (App. F, *infra*, 14a). Bancorp has not sought the Board's permission to engage in any other activities and has never applied to acquire an interest in any other bank. The Board's ruling cannot, of course, have any impact on Hibernia, not only because Hibernia has no connection with the conduct criticized by the Board but also because Hibernia already has obtained Board approval of an application to form a bank holding company (66 Fed. Res. Bull. 526 (1980)). Thus, there are no non-speculative reasons for inferring that the present litigation involves a live case or

controversy. See *SEC* v. *Medical Committee for Human Rights*, 404 U.S. 403, 406 (1972).[6]

In light of the importance of the question addressed by the court of appeals, the adverse impact of the court's decision on the Board's administration of the Bank Holding Company Act throughout the Ninth Circuit, and the possibility that it will spawn "legal consequences" elsewhere (*United States* v. *Munsingwear, Inc.*, *supra*, 340 U.S. at 41), the judgment of the court of appeals should be vacated summarily and the case remanded with instructions to direct the Board to withdraw its administrative decision as moot. *Great Western Sugar Co.* v. *Nelson*, *supra*, 442 U.S. at 93-94.[7]

---

[6] The authority relied on by the court of appeals (*Carroll* v. *President & Commissioners of Princess Anne*, 393 U.S. 175 (1968)) has no relevance here. In that case, this Court found that, while a ten-day injunction had expired, the substantive question involved in the litigation still remained unresolved and had a substantial continuing impact on the activities of the parties. In the present case, by contrast, there is no longer a live controversy between respondents and the Board concerning the bank holding company application, and vacation of the decisions of the Board and the court of appeals will not impair any legal right or interest.

[7] The court of appeals' reliance on the Board's failure to indicate any "desire to vacate" its administrative decision, in addition to being without factual support, is misplaced as a matter of law. The court of appeals has authority when it vacates its own decision as moot simultaneously to direct the agency to vacate its opinion and order on mootness grounds. *Great Western Sugar Co.* v. *Nelson*, *supra*, 442 U.S. at 93-94; *Mechling Barge Lines, Inc.* v. *United States*, 368 U.S. 324, 329 (1961) ("We think the principle enunciated in *Munsingwear* at least equally applicable to unreviewed administrative orders, and we adopt its procedure here. The [reviewing court] should have vacated the order which it declined to review.").

3. In the event that this Court does not agree that the present case is moot, further review on the merits is warranted. The plain language of the Bank Holding Company Act requires the Board to assess the "managerial resources" of each institution involved in each application to form a bank holding company. 12 U.S.C. (& Supp. III) 1842(c). Giving this language its ordinary meaning, the Board has authority not only to assess the skills, reliability, and integrity of management, but also to evaluate management's willingness to cooperate with the bank regulatory agencies.

a. That Congress intended the Board's inquiry into the quality of the managers of banking institutions to be broad is clear from the legislative history of the Bank Holding Company Act. As originally enacted in 1956, Section 3(c) of the Act directed the Board, in determining whether or not to approve a holding company application, to take into consideration five factors, including "the character of * * * management." 70 Stat. 135. As Congress recognized, this factor did not originate in the Bank Holding Company Act. That Act merely incorporated "the considerations now specified in the law as the basis for administrative action in connection with the admission of State banks to membership in the Federal Reserve System and the granting of deposit-insurance coverage." H.R. Rep. No. 609, 84th Cong., 1st Sess. 15 (1955). See *Board of Governors* v. *First Lincolnwood Corp., supra*, 439 U.S. at 244.

The statutes governing Federal Reserve System membership and federal deposit insurance require the appropriate banking agency to consider in each case "the general character of [the bank's] manage-

ment." 12 U.S.C. 322, 1816.[8] By incorporating into the Bank Holding Company Act the broad authority to consider the "character" of management, Congress clearly envisioned an inquiry that would extend to the integrity in general business matters of persons intending to serve as managers of federally regulated banking institutions.

Congress' substitution in 1966 of the phrase "managerial resources" for "general character of management" (80 Stat. 237-238) did not narrow the scope of the inquiry mandated by Congress. *Board of Governors* v. *First Lincolnwood Corp., supra*, 439 U.S. at 245-247. The language of Section 3(c) was revised solely to establish that the Board should consider the same factors that the banking agencies are required to consider in passing on applications under the Bank Merger Act. 12 U.S.C. (& Supp. III) 1828(c). See S. Rep. No. 1179, 89th Cong., 2d Sess. 9 (1966).[9]

b. The Board's broad authority under the Bank Holding Company Act is consistent with the authority granted by the provisions of other banking laws.[10]

---

[8] With respect to applications for membership in the Federal Reserve System, the Board routinely requires and considers biographical data—expressly including data bearing on nonbank business activities—of the applicant's managerial personnel. See Board of Governors of the Federal Reserve System, Form 83, *Application for Membership in the Federal Reserve System* 3-4 (1974).

[9] As originally enacted in 1960, the Bank Merger Act provided that the appropriate agency must consider "the general character of * * * management" of each bank involved. 74 Stat. 129. The 1966 revisions to the Bank Merger Act left unchanged the authority of the banking agencies in this regard. H.R. Rep. No. 1221, 89th Cong., 2d Sess. 4 (1966).

[10] Virtually every banking statute requiring federal agency consideration of "banking factors" mandates a broad inquiry into the character of the bank's management. See, *e.g.*, 12

Nothing in any of these statutes suggests that the appropriate banking agency must ignore the nonbank

---

U.S.C. (Supp. III) 1815(b); 12 U.S.C. (& Supp. III) 1828(d); 12 U.S.C. 1828(i). Although not required to do so by statute, the Comptroller of the Currency traditionally has reviewed "the general character and experience of the organizers and of the proposed officers" of a proposed or existing national bank in acting on applications to charter a new national bank or to open a branch of a national bank. See Stokes, *Public Convenience and Advantage in Applications for New Banks and Branches*, 74 Banking L.J. 921, 925 (1957). Character of management also is a factor to be considered in approving various applications by savings and loan associations and credit unions. See, *e.g.*, 12 U.S.C. (& Supp. III) 1464(e), 1726(c), 1730a(e)(2), 1754(2), and 1781(c)(1)(C). The Federal Home Loan Bank Board has concluded that the term "managerial resources" requires consideration of the general integrity of management. *Florida National Bank of Florida, Inc.*, 62 Fed. Res. Bull. 696, 698 (1976).

Under the recently enacted Change in Bank Control Act of 1978, 12 U.S.C. (& Supp. III) 1817(j), which requires prior approval by the appropriate agency for acquisition by an individual of 25 percent or more of the shares of an insured bank (12 U.S.C. (& Supp. III) 1817(j)(1), (8)), agency disapproval is warranted if the "competence, experience or integrity of any acquiring person or of any of the proposed management personnel indicates that [approval] would not be in the interest" of the bank's depositors or the public (12 U.S.C. (Supp. III 1817(j)(7)(D)). The proposed controlling party is required to supply information concerning his "identity, personal history, business background and experience" (12 U.S.C. (Supp. III) 1817(j)(6)(A)), and the agency may deny the proposed acquisition if the controlling party "neglects, fails, or refuses" to furnish the agency with "all the information required" by the agency (12 U.S.C. (Supp. III) 1817(j)(7)(E)).

Under the Financial Institutions Supervisory Act of 1966, 12 U.S.C. 1818(e), officers of an insured bank who have engaged in dishonest or unsafe acts with respect to another insured bank or *other business firm* may be removed from office after an adjudicatory proceeding. 12 U.S.C. (& Supp. III) 1818(e)(2).

business activities of bank managers when those activities reflect adversely on managerial integrity. Nor is a narrow view of the Board's protective function consistent with past Board practice. In connection with every application to form a bank holding company, the Board requires each applicant to supply information concerning the nonbank occupation (if any) of each principal of the applicant and each bank involved. See Board of Governors of the Federal Reserve System, *Application(s) for Prior Approval of Action to Become a Bank Holding Company*, F.R. Form Y-1, Exh. C, Item 4(c)(iv) (1979). If such information discloses illegal or untrustworthy conduct, the Board routinely considers such information in acting on the application.[11] The Board's interpretation of its own statutory mandate should have been respected by the court of appeals. See *Board of Governors* v. *First Lincolnwood Corp.*, *supra*, 439 U.S. at 251 ("courts should defer to an agency's construction of its own statutory mandate * * * particularly when that construction accords with well-established congressional goals").

c. Under the Board's interpretation of the Act, Khashoggi's alleged involvement in corrupt payments to foreign governmental officials was unquestionably material to an evaluation of his ability to occupy a position of trust in a federally regulated and insured banking institution. Such conduct is relevant to an informed appraisal of the integrity of management. Moreover, Khashoggi's refusal to

---

[11] Thus, the Board has denied applications because the proposed bank holding company has engaged in speculative nonbanking activities. See, *e.g.*, *Trust Co. of New Jersey-Wilshire Oil Co.*, 58 Fed. Res. Bull. 717, 718 (1972).

provide information to the Board, as well as the Department of Justice and the SEC, strongly suggested that he would prove uncooperative in discharging his future responsibilities under the Bank Holding Company Act. The court of appeals' conclusion that the Board had no legitimate reason to inquire into these subjects would severely restrict the scope of the Board's examination of "managerial resources."

The anomalous result reached by the court of appeals is especially serious in view of the fact that untrustworthy management is a primary cause of bank insolvencies. See pages 9-10, *supra*. Adjudicatory proceedings to remove dishonest or incompetent managers do not provide sufficient safeguards, since such proceedings are time consuming and may not achieve their objective until the harm has been done to the institution in question. The most effective method of preventing injury to the banking system is to prevent untrustworthy persons from assuming control of banking institutions and to encourage existing institutions to improve managerial resources. The court of appeals' failure to give effect to Congress' broad grant of authority to the Board to scrutinize managerial resources seriously impairs the Board's ability to protect the banking system and the public interest.

CONCLUSION

The petition for a writ of certiorari should be granted and the judgment of the court of appeals vacated as moot, with instructions to remand the case to the Board for vacation of its administrative decision. If the Court concludes that the present case is not moot, it should grant the petition and review the decision of the court of appeals on the merits.

Respectfully submitted.

LAWRENCE G. WALLACE
Acting Solicitor General

STUART E. SCHIFFER
Acting Assistant Attorney General

STEPHEN M. SHAPIRO
Assistant to the Solicitor General

ANTHONY J. STEINMEYER
FREDDI LIPSTEIN
Attorneys

MICHAEL BRADFIELD
General Counsel

RICHARD M. ASHTON
Attorney

Board of Governors of the
Federal Reserve System

JULY 1981

APPENDIX A

IN THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

Nos. 78-1581 and 78-2031

SECURITY BANCORP, a California Corporation, SECURITY NATIONAL BANK, A National Banking Association, PETITIONERS

v.

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM, RESPONDENT

Petitions for Review of Orders of the Board of Governors of the Federal Reserve System

OPINION

(Argued and Submitted May 12, 1980)

Filed Oct. 27, 1980

Before: HUG and SCHROEDER, Circuit Judges and BURNS,* District Judge

SCHROEDER, Circuit Judge:

In these petitions for review we must decide whether the Federal Reserve Board properly denied an application to become a bank holding company pursuant to the Bank Holding Company Act, 12

*Honorable James M. Burns, Chief Judge, United States District Court for the District of Oregon, sitting by designation.

U.S.C. §§ 1841-1849, and its requirement of adequate "managerial resources." 12 U.S.C. § 1842(c). The Board of Governors of the Federal Reserve System held that the applicant did not have adequate "managerial resources" and denied the application based upon the dominant shareholder's alleged past involvement in payments by American companies to foreign governments. 64 Fed.Res.Bull. 405 (1978). Because we believe that the Board interpreted "managerial resources" too broadly, we set aside its denial and order the Board to grant the application.

This case arises from an attempt to reorganize the Security National Bank of Walnut Creek, California. Ninety-seven percent of the stock in the bank is owned by Adnan M. Khashoggi. The management of the bank created another corporation, Security Bancorp, pursuant to a plan under which it would acquire all of the stock in the bank. Khashoggi would then become the principal shareholder in Security Bancorp with approximately the same percentage ownership as he had in the bank.

Under this reorganization Security Bancorp would become a "bank holding company" as that term is defined in section 2(a) of the Bank Holding Company Act, 12 U.S.C. § 1841(a). Security Bancorp therefore had first to obtain the approval of the Board of Governors of the Federal Reserve System. 12 U.S.C. § 1842(a). The factors which the Board is to consider in deciding whether to grant an application are set forth in 12 U.S.C. § 1842(c).[1] It directs

---

[1] 12 U.S.C. § 1842(c) provides:

The Board shall not approve—

(1) any acquisition or merger or consolidation under this section which would result in a monopoly,

the Board to consider, among other things, the "managerial resources" of the applicant and the bank or banks which it seeks to control. The section makes clear, however, that the primary purpose of the approval requirement is to prevent excessive concentration in the banking industry. *See Board of Governors* v. *First Lincolnwood Corp.*, 439 U.S. 234, 243, 99 S.Ct. 505, 510, 58 L.Ed.2d 484, —— (1978).

Security Bancorp filed its application in April, 1975. Although the application involved a routine corporate reorganization that would have had no effect on the operation of the bank or on the concentration of the banking industry in Northern California, and in spite of the Comptroller of the Currency's approval of the application, the Board, after considerable delay, denied the application in April, 1978. The Board viewed Khashoggi's alleged involvement in payments by American companies

---

> or which would be in furtherance of any combination or conspiracy to monopolize or to attempt to monopolize the business of banking in any part of the United States, or
>
> (2) any other proposed acquisition or merger or consolidation under this section whose effect in any section of the country may be substantially to lessen competition, or to tend to create a monopoly, or which in any other manner would be in restraint or [sic] trade, unless it finds that the anticompetitive effects of the proposed transactions are clearly outweighed in the public interest by the probable effect of the transaction in meeting the convenience and needs of the community to be served.
>
> In every case, the Board shall take into consideration the financial and managerial resources and future prospects of the company or companies and the banks concerned, and the convenience and needs of the community to be served.

to foreign governments, and his failure to respond to all of the Government inquiries into those activities, as reflecting unfavorably on the managerial resources of Security Bancorp and its bank. The matters under investigation were unrelated to the operation of any bank.

This appeal involves two consolidated petitions for review. The first, No. 78-1581, is from a Board order deferring action on the application. Security Bancorp asks this Court to declare the application to be deemed accepted by virtue of a provision of the Bank Holding Company Act which provides that completed applications not acted upon within 91 days are deemed accepted. 12 U.S.C. § 1842(b). The second, No. 78-2031, is an appeal from the final order of the Board denying the application. The dispositive issue in both is whether the Board, as part of its inquiry under "managerial resources," properly pursued an investigation into Khashoggi's activities wholly unrelated to bank management.

The leading case on the "managerial resources" requirement of the Bank Holding Company Act is *Board of Governors* v. *First Lincolnwood Corp.*, *supra*. There the Board also denied a bank holding company application on the ground of defective managerial resources. The Board found that the bank's capital was inadequate based on several measures of capital adequacy customarily used by the Board to determine whether to grant an application. It was conceded that the creation of the bank holding company would have had no adverse competitive effects and that the bank's financial health would not become any worse as a result of the creation of a bank holding company. The bank desired to use the holding company only as a device for obtaining

more favorable tax treatment and the use of a holding company would have had no substantive effect on the operation of the bank. The Seventh Circuit held en banc that the Board could not disapprove an application under these circumstances because the creation of the bank holding company had no adverse competitive effect and it did not exacerbate any defect in the bank's managerial resources. 560 F.2d 258 (7th Cir. 1977). The Supreme Court reversed and held that the Board could disapprove an application if the bank's capital was inadequate.

The Board relies on *First Lincolnwood* for the proposition that its power to disapprove applications on the ground of defective managerial resources is very broad. However, the case simply held that the Board could look at the adequacy of bank capital. It did not extend the scope of the term "managerial resources" to matters beyond the financial condition of the bank or management's conduct of bank affairs.

In every Board decision of which we are aware involving denial of an application or order for divestiture because of defective managerial resources, the defect was one which bore directly on the operation of the bank. The Board has often applied the managerial resources requirement to the applicant's financial health. *E.g.*, *Bankshares of Hawley, Inc.*, 62 Fed.Res.Bull. 610 (1975); *Citizens Bancorp*, 61 Fed.Res.Bull. 806 (1975); *Midwest Bancorporation*, 56 Fed.Res.Bull. 948 (1970). In other cases the Board has considered whether problems existed with respect to corporate organization, possible conflicts of interest, or lack of competent management. *E.g.*, *Mid-Continent Bancorporation*, 52 Fed.Res.Bull. 198 (1966); *Bancorporation of Minnesota*, 51 Fed.Res. Bull. 1085 (1965); *Clayton Bankshares Corp.*, 50

Fed.Res.Bull. 1261 (1964). In still other cases the management had failed to secure the Board's approval before acquiring a bank. *E.g., The Berlin City Bank*, 63 Fed.Res.Bull. 268 (1977); *Seilon, Inc.*, 63 Fed. Res.Bull. 156 (1977); *Florida National Banks of Florida*, 62 Fed.Res.Bull. 696 (1976).

The Board itself has recognized that managerial resources do not include matters entirely collateral to the purposes of the Bank Company Holding Act. *American Security Corp.*, 62 Fed.Res.Bull. 255 (1976) (employment discrimination). *See also Westtern Bankshares, Inc.* v. *Board of Governors*, 480 F.2d 749 (10th Cir. 1973) ("public interest", another factor the Board is to consider, does not include the price at which the bank is acquiring the stock of another bank). This is apparently the first and only case in which the Board has attempted to construe managerial resources so broadly as to encompass the private, non-banking affairs of a shareholder, officer, or director of an applicant holding company or bank.

In this case there has never been any suggestion that Security Bancorp or its subsidiary bank are financially unsound or mismanaged, or that the officers or directors have attempted to avoid the requirements of the Bank Holding Company Act or other federal banking law. The Board's concern is rather that the primary shareholder, Khashoggi, has been named as one who had assisted American corporations in making payments to foreign government officials. At the time of these alleged payments Khashoggi would have violated no United States law in doing what he is alleged to have done, although such payments have since been criminalized under the Foreign Corrupt Practices Act, 15 U.S.C. §§ 78a, 78dd-1, 78dd-2, 78m(b), 78ff.

The issue before us, however, is not whether Khashoggi's conduct was reprehensible, but whether it is relevant to management of the bank. It is not alleged that bank funds were in any way endangered by Khashoggi's alleged participation in these activities. The alleged payments occurred years before Khashoggi became a shareholder of Security National, and while Khashoggi may have profited personally by acting as a middleman in these transactions, neither the bank which he owns nor its customers were prejudiced.

The Board also points to the policy statement of several federal banking agencies that making "improper payments" is an unsound banking practice. 43 Fed.Reg. 2759 (1978). The purpose of this declaration is to protect "the funds of the institution." But the conduct allegedly engaged in by Khashoggi was unconnected to the assets of any banking institution here involved.

The Board's attempt to deny this application on the basis of Khashoggi's alleged conduct appears tantamount to engrafting upon the Bank Holding Company Act a good moral character requirement.[2] Since Congress has chosen not to make such a requirement, we hold that the Board cannot create one under the guise of managerial resources.

The order of the Board is set aside and the Board is ordered to grant the application. 12 U.S.C. § 1848.

---

[2] There are no federal restrictions on who may become a shareholder of a national bank. 12 U.S.C. §§ 61-62, 64a, 66-67 regulate shareholders with respect to such matters as voting rights, lists of shareholders, and individual liability. Even with respect to officers and directors the qualifications are modest. *See* 12 U.S.C. § 72 (citizenship, residency, and ownership requirements for directors); 12 U.S.C. § 78 (securities dealers cannot be officers or directors).

APPENDIX B

UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

No. 78-1581, 78-2031

SECURITY BANCORP, a California Corporation, SECURITY NATIONAL BANK, A National Banking Association, PETITIONERS

v.

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM, RESPONDENT

FRB No.

Upon Petition to Review a Decision of The Federal Reserve Board of the United States of America

JUDGMENT

This Cause came on to be heard on the Transcript of the Record from The FRB of the United States, and was duly submitted.

On Consideration Whereof, it is now here ordered and adjudged by this Court, that the Decision of the said FRB of the United States in this Cause be, and

hereby is SET ASIDE AND THE BOARD IS ORDERED TO GRANT THE APPLICATION.

A True Copy
Attest

RICHARD H. DEANE
Clerk of Court

by: /s/ Oscar Tagle
Deputy Clerk

Filed and entered October 27, 1980

APPENDIX C

IN THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

Nos. 78-1581 and 78-2031

SECURITY BANCORP, a California Corporation, SECURITY NATIONAL BANK, A National Banking Association, PETITIONERS

v.

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM, RESPONDENT

Petitions for Review of Orders of the Board of Governors of the Federal Reserve System

SUPPLEMENTAL OPINION

Filed Apr. 10, 1981

Before: HUG and SCHROEDER, Circuit Judges and BURNS,* District Judge

PER CURIAM

Following issuance of our opinion in this matter, but prior to the denial of the motion for rehearing, the government moved to vacate the opinion as moot because of the merger of Security Bancorp with another bank and the sale of Mr. Khashoggi's shares in Security Bancorp. The government has not indicated

---

* Honorable James M. Burns, Chief Judge, United States District Court for the District of Oregon, sitting by designation.

any desire to vacate the Federal Reserve Board's decision denying a permit to Security Bancorp, and such action would be required if this Court were to vacate its opinion reversing the Board. *See* [*Great*] *Western Sugar Co.* v. *Nelson*, 442 U.S. 92, 93 (1978). The petitioners have opposed the motion and have expressed concern about the effects of this controversy upon possible future dealings between the principals should this matter not be resolved. *See Carroll* v. *President & Comm'rs of Princess Anne*, 393 U.S. 175 (1968); C. Wright, A. Miller & E. Cooper, 13 Federal Practice and Procedure § 3533 at 280-81 (1975). In view of the discretion inherent in dismissing appeals when a particular controversy has expired, *see Alton & Southern Railway Co.* v. *International Assoc. of Machinists*, 463 F.2d 872, 880 (D.C. Cir. 1972), we decline to vacate the opinion on grounds of mootness. The respondent's motion to vacate the decision is denied.

APPENDIX D

IN THE
UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

Nos. 78-1581 and 78-2031

SECURITY BANCORP, a California Corporation, SECURITY NATIONAL BANK, A National Banking Association, PETITIONERS

v.

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM, RESPONDENT

ORDER

Filed Apr. 30, 1981

Before: HUG and SCHROEDER, Circuit Judges and BURNS*, District Judge

The panel as constituted above has voted to deny the petition for rehearing and to reject the suggestion for rehearing en banc.

The full court has been advised of the suggestion for rehearing en banc, and no judge of the court has requested a vote on the suggestion for rehearing en banc. Fed. R. App. P. 35(b).

The petition for rehearing is denied and the suggestion for rehearing en banc is rejected.

---

* Honorable James M. Burns, Chief Judge, United States District Court for the District of Oregon, sitting by designation.

APPENDIX E

IN THE
UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

Nos. 78-1581 and 78-2031

SECURITY BANCORP, a California Corporation,
SECURITY NATIONAL BANK, A National Banking
Association, PETITIONERS

v.

BOARD OF GOVERNORS OF THE
FEDERAL RESERVE SYSTEM, RESPONDENT

ORDER

Filed May 26, 1981

Before: HUG and SCHROEDER, Circuit Judges and BURNS*, District Judge

Respondent's motion to reconsider the Supplemental Opinion in this case is denied. Respondent's Petition for Rehearing and Suggestion for Rehearing En Banc were denied by order filed April 30, 1981.

---

* Honorable James M. Burns, Chief Judge, United States District Court for the District of Oregon, sitting by designation.

APPENDIX F

STATEMENT BY BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM REGARDING APPLICATION OF SECURITY BANCORP TO FORM A BANK HOLDING COMPANY

Security Bancorp, Walnut Creek, California, has applied for the Board's approval under § 3(a)(1) of the Bank Holding Company Act, 12 U.S.C. § 1842(a)(1) of formation of a bank holding company by acquiring all of the voting shares (less directors' qualifying shares) of the successor by merger to Security National Bank, Walnut Creek, California ("Bank"). The proposed acquisition of shares of the successor organization is treated herein as the proposed acquisition of shares of Bank. By Order dated April 14, 1978, the Board denied this application for the reasons set forth below.

Notice of the application, affording opportunity for interested persons to submit comments and views has been given in accordance with § 3(b) of the Act, 12 U.S.C. § 1842(b). The time for filing comments and views has expired, and the Board has considered the application and all comments received in light of the factors set forth in § 3(c) of the Act, 12 U.S.C. § 1843(c).

Applicant is a nonoperating corporation organized for the purpose of becoming a bank holding company through the acquisition of Bank ($156.9 million in deposits).[1] Upon acquisition of Bank, Applicant would control the 31st largest banking organization

---

[1] All banking data are as of June 30, 1977.

in California and .2 per cent of total deposits in commercial banks in the State.

Bank is the 14th largest banking organization in the relevant banking market,[2] controlling .5 per cent of the deposits therein. The proposed transaction involves a transfer of ownership of Bank from an individual to a corporation owned by the same individual and consummation of the proposal would not have any adverse effect upon existing or potential competition nor would it increase the concentration of banking resources in the market. Thus, the Board concludes that competitive considerations are consistent with, but do not lend weight toward, approval of the application.

The financial resources and future prospects of Applicant and Bank are considered satisfactory and consistent with approval of the application. While there would be no immediate increase in the services offered by Bank as a result of the proposed transaction, the consideration relating to the convenience and needs of the community to be served are consistent with approval of the application.

Applicant's principal shareholder is Adnan M. Khashoggi, a Saudi Arabian citizen. Mr. Khashoggi, primarily through his personal holding company, Triad Holding Corporation, S.A., Luxembourg, has worldwide investments in companies engaged in international trade, investment banking and finance. He also serves as sales agent for various companies. Approximately 97 per cent of the voting shares of Bank are owned by Mr. Khashoggi and approximately the same proportion of the voting shares of Appli-

---

[2] The relevant banking market is approximated by the San Francisco SMSA.

cant would be owned by him after consummation of the proposed transaction.

The Board's analysis of the managerial resources of an Applicant or its proposed subsidiary bank does not customarily extend to shareholders who do not serve as officers, directors or policy-making employees of those organizations.[3] In the Board's view, however, where an individual exercises a pervasive or controlling influence, or has the power to exercise such influence, over an organization, whether by reason of stock ownership or control over officers, directors or employees, that individual may appropriately be regarded as part of the organization's managerial resources, and the Board may consider such an individual in its assessment of an organization's managerial resources.

Mr. Khashoggi's ownership of approximately 97 per cent of the voting shares of Bank enables him to elect all of Bank's directors and to control and direct Bank's management. In addition to electing Bank's board of directors, the record reflects that Mr. Khashoggi provides broad guidance to Bank in

---

[3] The Bank Holding Company Act requires that the Board, in acting on an application to acquire a bank, inquire into the financial and managerial resources of an applicant. While this proposal involves the transfer of ownership of Bank from an individual to a corporation owned by the same individual, the Act requires that, before an organization is permitted to become a bank holding company, and thus obtain the benefits associated with the holding company structure, it must secure the Board's approval. Section 3(c) of the Act provides that the Board must, in every case, consider, among other things, the financial and managerial resources of both the applicant company and the bank to be acquired. The Board's action in this case is based on a consideration of such factors.

terms of his own objectives as principal shareholder. In view of the above and other facts of record, it is the Board's judgment that Mr. Khashoggi's ability to influence Bank is such that he should be considered as part of its management.

During the pendency of the subject application, the Board was aware that investigations were being conducted by United States law enforcement authorities into questionable payment practices by United States companies and that those investigations also involved Mr. Khashoggi. In view of the investigations and Mr. Khashoggi's important position with respect to Bank and the proposed bank holding company, the Board requested from the United States Department of Justice and the Securities and Exchange Commission any information concerning Mr. Khashoggi that may be relevant to the banking factors the Board is required to consider under the Act. In connection with their investigations, the Department of Justice and the SEC have sought Mr. Khashoggi's testimony. Mr. Khashoggi, however, has been unwilling to submit to questioning in a manner satisfactory to those agencies. As a result of Mr. Khashoggi's lack of cooperation in these matters, the agencies have been unable to respond adequately to the Board's requests for information.

On February 17, 1978, the Board considered the subject application and was advised of negotiations then in progress between the Department of Justice and representatives of Mr. Khashoggi whereby it was anticipated that an agreement might have been reached in the near future for Mr. Khashoggi to submit to questioning. In view of the incomplete record and the prospect that those negotiations might soon result in an agreement, the Board decided not to

take final action on the application at that time. Rather, the Board acted to defer a final decision on the application for 60 days and informed Applicant that when the Board reconsidered the application a relevant factor would be the status of the above investigations and, in particular, Mr. Khashoggi's cooperation in those investigations. It was the Board's judgment that deferral of final consideration for a short period was reasonable under the circumstances.

Since it last considered the application, the Board has been informed that the negotiations with Mr. Khashoggi have been terminated and that he has not evidenced a willingness to cooperate with the agencies in their investigations. As a result, Mr. Khashoggi's lack of cooperation leaves unanswered the Board's original requests for information from the Department of Justice and the SEC. In addition, his lack of cooperation with formal investigations undertaken by United States law enforcement authorities raises some concern whether Mr. Khashoggi would be personally available and accountable to bank supervisory authorities should the need arise. In the Board's view, a requirement for a favorable finding with respect to an Applicant's managerial resources is that management will be accessible to and cooperate with supervisory personnel. Furthermore, Mr. Khashoggi's unwillingness thus far to cooperate with United States law enforcement authorities is not in keeping with what the Board regards as acceptable conduct for the management of a bank holding company.[4]

---

[4] See also, *Florida National Banks of Florida, Inc.* 62 *Fed. Res. Bull.* 696 (1976).

On the basis of the foregoing and the facts of record, the Board is unable to reach a favorable conclusion with respect to the managerial resources of Bank or Applicant. While the other factors the Board is required to consider in action on the application are consistent with approval, they are not sufficient to outweigh the adverse managerial factors relating to the subject application. Accordingly, it is the Board's judgment that approval of the application would not be in the public interest and the application should be denied.

Board of Governors of the Federal Reserve System, effective May 2, 1978.

/s/ Griffith L. Garwood
GRIFFITH L. GARWOOD
Deputy Secretary of the Board

[SEAL]

★ U. S. GOVERNMENT PRINTING OFFICE: 1981 350926 549

Opposition

Office - Supreme Court, U.S.
FILED
NOV 6 1981
ALEXANDER L. STEVAS,
CLERK

No. 81-176

IN THE

Supreme Court of the United States

OCTOBER TERM, 1981

BOARD OF GOVERNORS OF THE
FEDERAL RESERVE SYSTEM, PETITIONER

vs.

SECURITY BANCORP AND SECURITY NATIONAL BANK

Brief in Opposition to a Petition for a Writ of Certiorari

JOHN L. HOSACK
PAUL E. GASPARI
EDWARD J. LEAHY

TOBIN & TOBIN
A Professional Corporation
2600 Crocker Plaza
One Post Street
San Francisco, California 94104
(415) 433-1400

Attorneys for Respondent
The Hibernia Bank,
successor by merger to
Security National Bank

BORG PRINTING COMPANY OF CALIFORNIA, 346 FIRST STREET, SAN FRANCISCO 94105

QUESTIONS PRESENTED

(1) Whether the Board of Governors of the Federal Reserve System can deny an application for holding company status based on uninvestigated rumors concerning an absentee shareholder under the guise of an evaluation of management resources.

(2) Whether it is appropriate to vacate the Appellate Court's decision which prevents the Board from exceeding its authority by endlessly delaying and finally denying holding company status on impermissible grounds.

TABLE OF CONTENTS

	Page
Statement	1
Argument	
A. The Board Has Overreached Its Authority to Evaluate Financial or Managerial Soundness by Denying an Application Based on Supposition Concerning an Absentee Shareholder Which the Board Failed to Investigate	2
1. There Was No Issue of Financial or Management Unsoundness	2
2. The Shareholder Was Not a Member of Bank Management in Law or Fact	4
3. A Shareholder's Failure to Agree on Terms of Assistance to Justice and SEC Is Not a Basis for Denial of the Application	6
4. The Board Has Exceeded Its Statutory Authority by Imposing a Requirement of Good Moral Appearances on Shareholders	8
B. Declaration of Mootness and Vacation of Appellate Court's Ruling Is Inappropriate	10
1. Having Been in Receipt of the Application for Nearly 5 Years, the Board Cannot Avoid the Court's Decision by Claiming Mootness	10
2. Vacating the Court's Decision Provides an Insufficient Remedy	11
Conclusion	12

TABLE OF AUTHORITIES

Cases

Pages

Security Bancorp v. Board of Governors, Etc., 655 F.2d 164 (1980) 3

Board of Governors v. First Lincolnwood Corp., 439 U.S. 234, 58 L.Ed.2d 484, S. Ct. 505 (1978) 3

Tri-State Bancorp Inc. v. Board of Gov. Fed. Res. System, 524 F2d. 562 (1975) 10

Moore v. Ogilvie 394, 67 S. Ct. 1493 23 L.Ed.2d 1 (1969) 11

Administrative Decisions

Bancorp of Minnesota, 51 Fed.Res.Bull. 1085 (1965).... 4

Statutes

12 U.S.C. § 73 4
12 U.S.C. § 93 4
12 U.S.C. § 501a 4
12 U.S.C. § 503 4
12 U.S.C. § 1818(e) 5

Reports

H.R.Rep.No. 91-387, 91st Cong.2d Sess 13 (1970-1) 10

No. 81-176

IN THE

Supreme Court of the United States

OCTOBER TERM, 1981

BOARD OF GOVERNORS OF THE
FEDERAL RESERVE SYSTEM, PETITIONER

vs.

SECURITY BANCORP AND SECURITY NATIONAL BANK

Brief in Opposition to a Petition for a Writ of Certiorari

STATEMENT

In April 1975, respondent Security Bancorp ("Bancorp") applied to the petitioner Board of Governors of the Federal Reserve System ("Board") for permission to become a one bank holding company by acquiring respondent Security National Bank ("Bank"). Faced with a Congressional mandate to rule on the Application within 91 days (12 U.S.C. Section 1842(b)), the Board failed to act on the Application until after Bank and Bancorp filed suit some 2½ years later. In its ruling on the Application, the Board did not challenge either the capital adequacy or the managerial soundness of the officers or directors of Bank and Bancorp. In fact, aside from taking issue with one of the Bank's shareholders, the Board found all other factors favored approval.

While recognizing that the Board's analysis "does not customarily extend to shareholders who do not serve as

officers, directors or policy-making employees", the Board sought to apply a new standard in this case because of some potential "influence" evidenced, according to the Board, by the election of a board of directors and by a claim of some unspecified "broad guidance" given the Bank which is not identifiable from the facts.

The Board denied the application on the basis of one shareholder's inability to reach agreement with two unrelated government agencies concerning the manner in which the shareholder would assist these agencies in their investigation of major U.S. multinational companies which were not customers of the Bank and with which the shareholder held no position.

The Board claims that these investigations by unrelated government agencies may have provided information which the Board earlier considered so irrelevant and immaterial that it failed to make any inquiry of the shareholder during the 2 year period prior to denial of the Application.

The United States Court of Appeals for the Ninth Circuit reviewed the Board's ruling and on October 27, 1980 ordered the application granted. On January 1, 1981 The Hibernia Bank acquired by merger Security National Bank. The Board urged the Ninth Circuit to thereafter vacate its decision and that Appellate Court rejected those petitions.

ARGUMENT

A. The Board Has Overreached Its Authority to Evaluate Financial or Managerial Soundness By Denying an Application Based on Supposition Concerning an Absentee Shareholder Which the Board Failed to Investigate.

1. THERE WAS NO ISSUE OF FINANCIAL OR MANAGEMENT UNSOUNDNESS.

As the Ninth Circuit found, there has never been any suggestion that Bank or Bancorp were financially unsound or that the officers and directors were either incompetent or

corrupt. 655 F.2d 164 (1980), 167. This conclusion of the Court is supported by the Board's own ruling on the Application which never raised any issue nor cited any findings of fact indicating any deficiency on the part of the managing officers or directors or indicating financial weakness. To the contrary, the Court found that the financial condition of the Bank favored approval and that all other factors considered by the Board unrelated to the shareholder favored approval. Moreover, the Board's staff even went so far as to perform its own independent investigation of the Comptroller of the Currency's records and yet no evidence is presented that the Bank was financially unsound or that the managing officers and directors of the Bank were in any way deficient.

The present controversy is completely distinguishable from *Board of Governors* v. *First Lincolnwood Corp.*, 439 U.S. 234, 58 L.Ed.2d 484, S. Ct. 505 on which petitioner so heavily relies. That case involved a bank which was undercapitalized according to the Comptroller of the Currency, the Federal Reserve Bank, the Board's staff analysis, the Board's ruling on the application and the Court of Appeal's finding. In present controversy there is no finding by the Board's staff of any financial inadequacies or any deficiency on the part of the managing officers and directors. The Board's ruling on the application makes no such claims. The Federal Reserve Bank of San Francisco and the Comptroller of the Currency favored approval. The Court of Appeal found that there was not even a suggestion of financial unsoundness or deficiency on the part of the officers and directors managing the Bank. Thus, the holding in *Lincolnwood* that "the Board may deny applications for holding company status solely on the grounds of financial or managerial unsoundness. . ." (Ibid at 252) is inapplicable here

as the Board has not found or even asserted any financial weakness or any managerial unsoundness among the officers and directors of the Bank.

2. THE SHAREHOLDER WAS NOT A MEMBER OF BANK MANAGEMENT IN LAW OR FACT.

The Board attempts to bootstrap the shareholder into management in disregard of relevant law and facts. No prior Board decisions have ever extended the term "management" to shareholders. See *Bancorp of Minnesota* (1965) 51 Fed.Res.Bull. 1058, 1088. Even the Board admits, in its ruling on the Application, that managerial resources of the Bank do not customarily extend to shareholders who do not serve as officers, directors or policy-making employees. Yet in this case, the Board has chosen to include the shareholder because he "has the power" to exercise influence over the Bank. This influence, according to the Board, is evidenced by electing a board of directors, the normal duty of shareholders, and by providing some unspecified "broad guidance" to the Bank which is not identifiable from the facts.

The Board's assertion that it may consider as management any shareholder who has the potential to influence a bank is contrary to the basic legal concept of corporate organization and the relationship between shareholders on the one hand and the directors and officers on the other. Shareholders can only elect directors. Under the National Banking Act each director takes an oath that he will honestly administer the affairs of the banking association and will not violate or willingly permit the violations of the Banking Act (12 U.S.C. § 73). Each director is strictly accountable for his actions, as are the officers who are elected by the directors (12 U.S.C. §§ 93, 501a, 503). The

management of a national bank is entrusted to the directors and officers of the bank, not the shareholders. Officers and directors are also subject to strict regulation and can be removed from office by the Comptroller and the Board (12 U.S.C. § 1818(e)).

Shareholders are appropriately placed in a different category; they do not and cannot manage a national bank. The Board cites no legal basis for including shareholders as a part of management. Even if there were a statutory basis for permitting shareholders to be considered as a part of management, such a finding would have to be based on something other than the Board's hypothesis of potential influence.

The shareholders can only elect board members and the record discloses that the Bank was managed by an independent Board of Directors. The directors represented a cross section of highly qualified individuals, principally from the Walnut Creek area. In fact three of the directors had been directors since 1963, some ten years before the shareholder in question acquired any shares of the Bank. One director was a former Mayor of the City of Walnut Creek, another was a well-known educator and all others were highly respected business leaders (R 428).

The record shows that the shareholder in question was a passive investor. He is not a banker. His interests, as the Board notes, include real estate development, manufacturing and investment and management services (R 179-182). Banking is a specialized and highly regulated industry and the record shows that, for the management of Bank, the shareholder relied upon the senior management of the Bank (all professional American bankers) and an independent board of directors, none of whom had prior personal or business dealing with him before he purchased controlling interest in Bank in November 1972. It is these officers and

directors who originated, developed and implemented the banking policies and practices of the bank. (R 351-53). This shareholder, as an absentee owner who did not participate in the Bank's activities, was only provided with quarterly and annual reports showing the productive efforts of the officers and directors (R 351). This shareholder had not, in over four years, provided any banking policy suggestions to the Bank's management. He had visited the Bank only once (in 1974) since purchasing his shares. The information he received on the Bank's condition and progress was essentially the same as supplied to all of the Bank's shareholders. He had not received, nor even requested, any dividends or other distributions since becoming a shareholder. Furthermore, the record demonstrates that the policy of the Bank adopted by the Bank's Board of Directors was that there would be no credit extended to, or other transactions for the benefit of this shareholder, or his various related companies or affiliates. (R 352). This policy had been monitored by the Comptroller, and the Federal Reserve Bank of San Francisco acknowledged that this policy had been complied with. (R 446).

Accordingly, a proper characterization of the record shows that this shareholder had refrained from taking any active role in the management and decision policies of Bank and was truly a passive investor, who relied upon the expertise of professional management and an independent Board of Directors.

3. A SHAREHOLDER'S FAILURE TO AGREE ON TERMS OF ASSISTANCE TO JUSTICE AND SEC IS NOT A BASIS FOR DENIAL OF THE APPLICATION.

The Board asserts in its petition but not in its own ruling that the shareholder failed to provide the Board with information. The record shows, however, that the shareholder had, in fact, cooperated at all times with all

banking regulators, including the Board. While the Board concedes that it probably has no authority under the Act to compel a principal shareholder to provide information (RB 35), the record shows that this shareholder provided all information ever requested of him by the Board on numerous occasions, as did Bank and Bancorp (R 190-95; 208-11; 216-19; 220-25; 235-40). The Board acknowledged on January 26, 1976 and again on June 17, 1976, that no additional information was required of Applicant. While the Board now claims that the record was incomplete, at no time after January 1976 did the Board request any additional information from the shareholder. The record also shows ongoing cooperation by this shareholder with the Comptroller of the Currency, the primary regulator of national banks (R 445-46). The Board's own detailed analysis of the Comptroller's records failed to reveal any evidence supporting the Board's alleged concern (R 282).

The Board's position that the shareholder's inability to agree upon the terms of cooperation with Justice and SEC is sufficient grounds to deny the Application is untenable. In its ruling, the Board stated that a favorable finding requires that management be accessible to and cooperate with supervisory personnel. There has been no showing or suggestion that the officers or directors of the Bank are unwilling to cooperate. If this shareholder is to be considered part of management, he too has shown his willingness to cooperate with the Board and other regulatory authorities by providing all requested information even in instances where the Board concedes it probably had no authority over him.

In its Petition, the Board implies that it might have discovered information material and relevant to the Application from the shareholder's assistance to Justice and the

SEC. Yet, in January 1976 Applicant was informed that no additional information was required and during the more than two intervening years leading to denial, the Board sought no further information from the shareholder.

As this shareholder has shown a willingness to cooperate with all federal banking authorities, and as the Board found whatever information it might have obtained so immaterial and irrelevant that it failed to make a single inquiry of this shareholder for a period of more than two years, one is left with the conclusion that the Board finds that failure to assist any government agency is "unacceptable conduct."

The Board's position means if the Board is aware that another governmental agency seeks the cooperation of an individual, who is also a shareholder of an applicant, in an investigation or other matter unrelated to the banking business, the Board can ignore the limited legal grounds for denying a bank holding company application and, until that individual cooperates on terms agreeable to that other agency, the Board can refuse to act, withholding approval of an application which otherwise meets all the requirements of the Board. Such action constitutes a clear abuse of the Board's administrative authority.

4. THE BOARD HAS EXCEEDED ITS STATUTORY AUTHORITY BY IMPOSING A REQUIREMENT OF GOOD MORAL APPEARANCES ON SHAREHOLDERS.

In *First Lincolnwood*, supra, this Court held that the Board could deny an application on the grounds of capital inadequacy even where there is no anticompetitive effect if its conclusions are supported by substantial evidence. In the present controversy the Board has tried to bootstrap its authority to examine the soundness of the managing officers and directors of a bank into the power to deny an application on the basis that a purely passive investor is

alleged to have committed some acts which are neither illegal nor unethical and which the Board failed to take the opportunity to investigate.

The Board has never charged that the shareholder has committed any questionable act or that any such supposed act was illegal. Even in its ruling on the Application, following a two-year period in which the Board made no inquiry of the shareholder, the Board merely reported the existence of allegations. There has been no finding by the Board that the acts occurred or that any law was violated. The shareholder denied that any illegal or improper act occurred and, for a period of more than two years, the Board failed to make a single further inquiry of him.

Even if the acts occurred, they were the accepted business practices of the time, being conducted by over 300 of some of the most prestigious companies in the United States (R 452). And, as the Court of Appeal found, such acts, if committed, would not have violated any U.S. law. Some years later, of course, the Foreign Corrupt Practices Act was passed. But there has been no showing that any acts, if committed, would have violated these restrictions. Furthermore, to reject the Application on the basis of unsubstantiated and uninvestigated rumors of conduct which, if committed, might have violated legislation enacted after the fact violates the most fundamental legal principle of no *ex post facto* application of law.

While the Board should have some latitude in evaluating managerial or financial unsoundness which falls within the Board's particular area of technical expertise, for the Board to require the shareholders to maintain some undefined good moral appearance acceptable to the Board completely exceeds its authority. Thus, the Appellate Court is correct in holding that the Board has exceeded its legislative authority in attempting to engraft upon the Bank Holding

Company Act a good moral requirement under the guise of managerial resources.

B. Declaration of Mootness and Vacation of Appellate Court's Ruling Is Inappropriate.

1. HAVING BEEN IN RECEIPT OF THE APPLICATION FOR NEARLY 5 YEARS, THE BOARD CANNOT AVOID THE COURT'S DECISION BY CLAIMING MOOTNESS.

Bank and Bancorp's Application had been pending since April 1975, almost 3 years before Applicant brought suit in an attempt to force the Board to take some kind of action. The Board was under a Congressional mandate to rule on the Application within 91 days because the Board had been "unduly slow in rendering decisions in applications made." H.R.Rep.No. 91-387, 91st Cong.2d Sess. 13 (1970-1). See *Tri-State Bancorp Inc. v. Board of Gov. Fed. Res. System*, 524 F.2d 562 at 564. The Board then rejected the Application on the grounds that there were outstanding inquiries which it had failed to make on its own behalf for more than 2 years.

After a law suit, nearly 5 years of endless delay and having yet to secure definitive approval of holding company status, the shareholder entered into negotiations to sell his interest in the Bank. While these negotiations were in progress and before sale was completed, the Board petitioned the Appellate Court to vacate its decision on the basis of mootness. Somehow, the Board feels that if a shareholder enters into negotiations to sell his shares an applicant should no longer even have the option of forming a holding company. The Board went so far as to argue that Applicant "made a calculated business decision" in opposing the Board's petitions to vacate while merger negotiations were being conducted. After 5 years of endless delay, the Board is in no position to argue mootness.

Coupled with the Appellate Court's finding on rehearing that the Board has not indicated any desire to vacate its ruling denying the Application, one is drawn to the conclusion that the Board is so adamantly opposed to allowing this shareholder stock in a bank holding company that it will grossly overstep its legislative authority, ignore its Congressional mandate to make timely rulings on applications and go so far as to suggest that Applicant should not have opposed the Board's attempts to have a Court ordered issuance of a charter reversed.

2. VACATING THE COURT'S DECISION PROVIDES AN INSUFFICIENT REMEDY.

The Board suggests that if the rulings in this case are vacated, the parties will be returned to their initial positions with no interest impaired. This is not the case. The whole tenor of the Board's objections to this shareholder has been to cast aspersions on his good name while failing to ascertain the truth of those aspersions. Any attempt to return the parties to their original positions will not vindicate the good name of the shareholder, a substantial interest impaired by the Board's actions. Further, the shareholder has gone to considerable legal expense and 5 years of effort to secure permission to form a holding company, which permission should be forthcoming in 91 days by Congressional mandate. Neither the effort, time nor money can be recouped. Moreover, vacation would do nothing to prevent the Board from endlessly delaying and finally denying holding company status to this or any other shareholders on the basis of unsubstantiated rumor which the Board fails to investigate.

Thus, this Court is faced with a situation similar to that in *Moore v. Ogilvie* 394, 67 S. Ct. 1493, 23 L.Ed.2d 1 (1969) where though the relief sought by the petitioner was no

longer needed (as the election had been held) the Court determined that the issue raised by the petitioner, involving interpretation of laws applicable to administering elections, was one that would be recurring and therefore ruled on the question raised in an opinion that served as a definitive interpretation for future election administration. This shareholder is entitled to know that should he or any other shareholder attempt to form a holding company, they will not suffer endless and perhaps fatal delay or be subject to uninvestigated aspersions of their good names.

CONCLUSION

The petition for a Writ of Certiorari should be denied as the Appellate Court's ruling prevents the Board from far overstepping its authority by endlessly delaying and denying an application on the basis of unsubstantiated and uninvestigated rumor concerning the alleged unrelated activities of an absentee shareholder who exerts no control over the Bank.

Respectfully submitted,

JOHN L. HOSACK
PAUL E. GASPARI
EDWARD J. LEAHY

TOBIN & TOBIN
A Professional Corporation

Attorneys for Respondent
The Hibernia Bank,
successor by merger to
Security National Bank

Petitioner's Reply Brief

Office - Supreme Court, U.S.
FILED
NOV 30 1981
ALEXANDER L. STEVAS,
CLERK

No. 81-176

In the Supreme Court of the United States

OCTOBER TERM, 1981

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM, PETITIONER

v.

SECURITY BANCORP AND SECURITY NATIONAL BANK

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

REPLY MEMORANDUM FOR THE PETITIONER

REX E. LEE
Solicitor General
Department of Justice
Washington, D.C. 20530
(202) 633-2217

MICHAEL BRADFIELD
General Counsel
Board of Governors of the Federal Reserve System
Washington, D.C. 20551

TABLE OF AUTHORITIES

Page

Cases:

Ashcroft v. *Mattis*, 431 U.S. 171 2

Board of Governors v. *First Lincolnwood Corp.*, 439 U.S. 234 5

Deposit Guaranty National Bank v. *Roper*, 445 U.S. 326 3

Moore v. *Ogilvie*, 394 U.S. 814 3

O'Shea v. *Littleton*, 414 U.S. 488 3

Schiaffo v. *Helstoski*, 492 F. 2d 413 3

Simon v. *Eastern Kentucky Welfare Rights Organization*, 426 U.S. 26 3

St. Paul Fire & Marine Insurance Co. v. *Barry*, 438 U.S. 531 3

Statutes:

Bank Holding Company Act of 1956, Section 3(c), 12 U.S.C. 1842(c) 4, 5

Change in Bank Control Act of 1978, 12 U.S.C. (& Supp. III) 1817:

12 U.S.C. (& Supp. III) 1817(j) 4

12 U.S.C. (Supp. III) 1817(j)(7)(D) 4

12 U.S.C. (Supp. IV) 72 5

12 U.S.C. (Supp. III) 1818(b)(1) 4

12 U.S.C. (Supp. III) 1818(b)(3) 4

12 U.S.C. (Supp. III) 1818(e) 4

Page

Statutes—(Continued):

12 U.S.C. (Supp. III) 1818(g) 4
12 U.S.C. (Supp. III) 1818(g)(1) 4
12 U.S.C. 1829 4
15 U.S.C. 78a 8
15 U.S.C. (Supp. III) 78dd-1 8
15 U.S.C. (Supp. III) 78ff 8
15 U.S.C. 78m(b) 8

Miscellaneous:

43 Fed. Reg. 2759 (1978) 8
Florida National Banks of Florida, Inc., 62 Fed. Res. Bull. 696 (1976) 7

In the Supreme Court of the United States

OCTOBER TERM, 1981

No. 81-176

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM, PETITIONER

v.

SECURITY BANCORP AND SECURITY NATIONAL BANK

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

REPLY MEMORANDUM FOR THE PETITIONER

---

1. Respondents have failed to identify any continuing legal interest that gives rise to a persisting, concrete dispute between the parties following the acquisition of respondent Security National Bank ("Security Bank") by Hibernia Bank (Br. in Opp. 2). Hibernia Bank has no connection with the application before the Board or the persons involved in that proposal. And as a result of its acquisition by Hibernia, Security Bank has ceased to exist. Thus, the application of respondent Security Bancorp ("Bancorp") for Board approval to acquire Security Bank—the only proposal presented to the Board—has no continuing legal or practical significance.

Moreover, contrary to respondents' contention (Br. in Opp. 11), the Board is fully prepared to vacate its order denying Bancorp's application upon vacation of the court of appeals' decision (see Pet. 7). That action by the Board on

remand would leave the parties in the same position they occupied before submission of the application and would eliminate the potential for any future effect upon them resulting from the Board's action.[1]

In these circumstances, respondents can point to no continuing legal stake that satisfies the case or controversy requirement. Khashoggi's asserted interest in vindicating his good name does not suffice. Absent a demonstration of particularized harm, "emotional" satisfaction resulting from successful conclusion of litigation involves no " 'present right' " of a party and "is not enough to meet the case-or-controversy requirement." *Ashcroft* v. *Mattis*, 431 U.S. 171, 172-173 (1977). Furthermore, as explained above, the Board's withdrawal of its order will remove any possible adverse reflection on Khashoggi's reputation.[2]

Finally, the fact that the question of statutory interpretation decided by the court of appeals might arise in some hypothetical future case does not give rise to a case or controversy here. As this Court has made clear, "abstract concern with a subject that could be affected by an adjudication does not substitute for the concrete injury required

---

[1]There is no basis for respondents' assertion (Br. in Opp. 11) that the Board is "adamantly opposed" to permitting respondents' dominant shareholder to become associated with any banking organization. Respondents do not assert that either Khashoggi or Bancorp—which was formed solely to acquire a bank that no longer exists—seeks, or is likely to seek, to acquire another bank. In any event, such an acquisition would require separate approval by the appropriate banking agencies based on the facts of the particular application. The actions of the banking agencies could then be challenged on judicial review in the context of a live case or controversy.

[2]Contrary to respondents' characterization, the court of appeals' decision did not "vindicate" Khashoggi's reputation. The court's decision rested on its conclusion that, as a matter of law, the Board was powerless to deny the application even if Khashoggi had engaged in "reprehensible" conduct (Pet. App. 7a).

by Art. III." *Simon* v. *Eastern Kentucky Welfare Rights Organization*, 426 U.S. 26, 40 (1976); see *O'Shea* v. *Littleton*, 414 U.S. 488, 494 (1974).[3]

It is settled that the mootness of a case "ousts the jurisdiction of the federal courts and requires dismissal of the case * * *." *Deposit Guaranty National Bank* v. *Roper*, 445 U.S. 326, 335 (1980). Accordingly, mootness cannot be waived, but must be addressed even if not raised by the parties. See *St. Paul Fire & Marine Insurance Co.* v. *Barry*, 438 U.S. 531, 537 (1978). Thus, respondents' contention that the Board is now precluded from raising mootness because of earlier delays in the processing of the application[4] and the resulting litigation is completely without merit.[5]

2. Respondents do not dispute the importance of the holding of the court of appeals or challenge our demonstration (Pet. 14-18) that the decision drastically limits the Board's traditional authority to examine all evidence bearing on the fitness of managerial personnel in a bank holding company formation. Nor do respondents question the proposition that sound management is a crucial element in assuring the safety of the nation's banking system. Rather,

---

[3]The sole authority cited by respondents, *Moore* v. *Ogilvie*, 394 U.S. 814 (1969), is wholly inapposite. *Moore* involved a challenge to a requirement specifying criteria for certification on the ballot in a presidential election—a requirement that "remains and controls future elections." *Id.* at 816. The Board's action here has no comparable effect.

[4]As demonstrated below, any delay in the Board's decision on the proposal was due solely to Khashoggi's refusal to provide meaningful information to the Board and to the Department of Justice and the SEC.

[5]The fact that respondents opposed the Board's petition for certiorari only after this Court directed a response to the petition underscores the absence of a continuing concrete dispute between the parties. Compare *Schiaffo* v. *Helstoski*, 492 F. 2d 413, 417 (3d Cir. 1974).

respondents attempt to defend the result reached by the court of appeals primarily on grounds not adopted by the court.

As respondents recognize, Section 3(c) of the Bank Holding Company Act of 1956, 12 U.S.C. 1842(c), requires the Board to examine the "managerial resources" involved in every proposed bank holding company formation. There is no legal or factual basis for respondents' contention (Br. in Opp. 4-6) that the Board is powerless to consider, in its review of the managerial resources of a banking organization, the conduct of a dominant shareholder who, while not an officer or director in name, does in fact influence and control the operations of the institution. The plain meaning of the term "managerial resources" encompasses more than those persons formally identified as officers or directors, and embraces those who actually direct the affairs of the banking organization.[6] Under respondents' contrary view, the Board would be unable to prohibit the formation of a bank holding company to be owned by a convicted criminal, who, while barred by statute from serving as an officer or director of the bank or holding company (see 12 U.S.C. (Supp. III) 1818(b)(3), (e), (g); 12 U.S.C. 1829), would

---

[6]Congress has often made explicit its view that persons (such as shareholders) other than officers or directors of a banking institution may be treated as managerial resources. For example, the Change in Bank Control Act of 1978, 12 U.S.C. (& Supp. III) 1817(j), governing acquisitions of banks by individuals (rather than by companies, which are governed by the Bank Holding Company Act), expressly permits denial of a proposed acquisition if the "competence, experience, or integrity" of any acquiring person, as well as of management personnel, are unsatisfactory. 12 U.S.C. (Supp. III) 1817(j)(7)(D). See also 12 U.S.C. (Supp. III) 1818(b)(1) and (g)(1), providing for administrative enforcement actions against any persons participating in the conduct of the affairs of a bank.

nevertheless be in a position to influence the operations of the institutions involved through nominees or sympathic officers and directors.[7]

The record in this case completely refutes respondents' claim that Khashoggi was merely a passive investor and supports the Board's finding (Pet. App. 15a-17a) that Khashoggi had the power to control both Bancorp and Security Bank and that he did in fact control the operation of Security Bank. Since Khashoggi owned virtually all (97%) of the shares of both Bancorp and Security Bank, he had the unrestrained power to select and control all of the directors as well as the officers of both institutions.

Even though he was precluded from serving as a director of the bank because he was not a citizen (12 U.S.C. (Supp. IV) 72), Khashoggi selected Security Bank's senior management personnel. All of the bank's senior management was associated with Khashoggi's other business ventures. Khashoggi's chief American adviser served as Security Bank's chief executive officer (R. 440).[8] As of 1976, six of Security Bank's directors and senior officers, including its chief executive officer, both executive vice presidents, and two senior vice presidents, held similar positions in one or more corporations controlled by Khashoggi (R. 315-316). The record shows, moreover, that Khashoggi exercised a

---

[7]Nothing in the Court's interpretation of Section 3(c) in *Board of Governors* v. *First Lincolnwood Corp.*, 439 U.S. 234 (1978), supports respondents' view that the term "managerial resources" should be narrowly limited to include only formally elected officers or directors. To the contrary, the Court's finding in *First Lincolnwood* that Congress has evidenced "substantial concern for the financial soundness of the banking system" (*id.* at 250) necessarily implies that the Board has power adequate to assure financial and managerial resources in connection with each bank holding company formation.

[8]"R." refers to the administrative record filed in the court of appeals.

pervasive influence over the day-to-day operations and policies of Security Bank. The bank's senior management provided Khashoggi with quarterly reports of the bank's operations and reviewed the bank's achievements and plans annually at Khashoggi's London office (R. 352-355). After obtaining control of Security Bank, Khashoggi endorsed major policies of the bank, including policies concerning the retention of earnings, strengthening of loan loss reserves, and transactions between the bank, Khashoggi, and his related companies (R. 350-353).[9]

In sum, the record amply supports the Board's finding, undistrubed by the court of appeals, that Khashoggi was part of the management of Security Bank.

3. Contrary to respondents' claims (Br. in Opp. 6-8), the record fully supports the Board's finding (Pet. App. 16a-18a) that Khashoggi in fact refused to cooperate with the Board, as well as the Department of Justice and the SEC, and refused to provide information necessary for the Board's analysis of his fitness to manage and control a bank holding company. As explained in our petition (Pet. 3-4), while Bancorp's application was pending before the Board, two United States corporations made public reports disclosing that they had made payments to Saudi Arabian government officials to influence government action and that Khashoggi had acted as the intermediary in making those payments (R. 212-213). In response to the Board's requests for information concerning Khashoggi's alleged participation in these practices, Khashoggi submitted a general denial of any wrongdoing (R. 220-222, 235-237). In

---

[9]Since Khashoggi owned virtually all of Bancorp's shares and proposed to install Security Bank's managerial personnel as Bancorp's management (R. 59-61, 170, 440), it also is evident that Khashoggi would have dominated the operation of Bancorp had the acquisition been approved.

light of the detailed reports of improper payments by the United States corporations, Khashoggi's blanket denial provided no meaningful information. Accordingly, the Board sought relevant information about Khashoggi's alleged role in such payments from the Department of Justice and the SEC, which at the time were conducting investigations of these and other alleged payments (R. 272-273). When it became clear, after an extended period of time, that Khashoggi did not intend to cooperate, the Board reasonably concluded that relevant questions remained unanswered and that Khashoggi would likely prove to be uncooperative in complying with the Board's supervisory directives.

Whether Khashoggi participated in making payments to influence foreign government officials is clearly germane to an analysis of the managerial resources of Bancorp and Security Bank. The Board is charged with investigating the honesty and integrity of managerial personnel, their disposition to conduct the affairs of the bank or holding company lawfully and in accordance with safe banking standards, and their willingness to cooperate with supervisory authorities.[10]

Indeed, Khashoggi's involvement in payments to foreign officials raised questions as to whether Bancorp or Security Bank would, under Khashoggi's influence, engage in similar misconduct in the future. While the application was pending, Security Bank began to seek business in the Middle East in conjunction with Khashoggi's business interests (R. 441). The danger of payments to foreign government officials by Bancorp or Security Bank was properly a matter of concern to the Board since such conduct would be an

---

[10]See, *e.g.*, *Florida National Banks of Florida, Inc.*, 62 Fed. Res. Bull. 696, 698 (1976).

unsound banking practice and a potential criminal violation. 15 U.S.C. 78a, 78m(b); 15 U.S.C. (Supp. III) 78dd-1, 78ff; 43 Fed. Reg. 2759 (1978). In this context, there clearly is no basis for respondents' claim that, in denying Bancorp's application, the Board was merely attempting to investigate good moral character or to enforce compliance with unrelated government inquiries (Br. in Opp. 6-7).

For the foregoing reasons, and for the additional reasons stated in the petition, the petition for a writ of certiorari should be granted and the judgment of the court of appeals should be vacated as moot, with instructions to remand the case to the Board for vacation of its administrative decision. If the Court concludes that the present case is not moot, it should grant the petition and review the decision of the court of appeals on the merits.

Respectfully submitted.

REX E. LEE
Solicitor General

MICHAEL BRADFIELD
General Counsel
Board of Governors of the
Federal Reserve System

NOVEMBER 1981

DOJ-1981-11